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C O N F I D E N T I A L SECTION 01 OF 02 BANGKOK 000469

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E.O. 12958: DECL: 02/12/2018
TAGS: [EFIN](#) [EINV](#) [ECON](#) [ETRD](#) [TH](#)
SUBJECT: THAILAND TO LIFT 30-PERCENT RESERVE REQUIREMENT
THIS YEAR

REF: BANGKOK 430 AND PREVIOUS

Classified By: Economic Counselor Robert D. Griffiths for Reason 1.4 (b)
) and (d)

¶1. (U) New Finance Minister Surapong Suebwonglee said February 12 that no decision had yet been made to immediately remove the 30 percent unremunerated reserve requirement (URR) after his two-hour meeting with Bank of Thailand (BOT) Governor Tarisa Watanagase. Surapong, also the PPP party's Secretary General, had said during the recent general

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election campaign that abolishing the URR would be a top priority of a PPP-led government "to send a powerful signal to foreign investors" that Thailand would redouble its efforts to attract foreign investment. However, since the new government's installation, senior BOT officials, including the Governor and her top aides, have urged the Finance Ministry to take a cautious approach to lifting the requirement. While a decision to remove the URR is considered inevitable this year, the BOT has expressed concern that a quick repeal of the controls would spur a sharp influx of foreign capital, adding to pressure for the Thai currency to appreciate. Thai exporter associations have also warned that they foresee a short-term 10 percent appreciation of the baht if the URR is removed.

¶2. (U) Surapong said the government would make a decision on the URR before embarking a planned international investment roadshow in late March and early April. "A clear-cut policy on the URR and the exchange rate should be finalized before I make a roadshow trip overseas," he said. "I would like to make sure I understand the situation completely," he said. He added, however, that "the central bank has to make its own decision on the 30 percent reserve requirement," and would make its decision after consultation with Surapong's Ministry.

THE URR - WHAT IS IT?

¶3. (U) When it was introduced on December 18, 2006, the 30 percent unremunerated reserve requirement (URR) applied to all short-term capital inflows (less than one year duration). The URR required all foreign capital inflows above USD 20,000 to have 30 percent of the principal amount deposited

with the Bank of Thailand for one year in a non-interest bearing account. The BOT argued that the URR was a temporary necessity to regulate "hot-money" flowing into Thai investment instruments from speculators betting that the baht would continue to appreciate. After a dramatic 15 percent drop in the Thai stock market index the day after the URR was announced, the Finance Ministry partially reversed the decision, repealing the URR requirement for any investment in Thai equities.

14. (U) Since that about-face, the BOT has gradually removed the URR measure in other areas, such as real estate and property funds, to the point where it currently only applies to foreign investment in bonds (government and private), mutual funds, and foreign currency borrowing. Investors also have the option of avoiding the 30 percent URR entirely if they fully hedge their investments for currency risk. They can do this by arranging a currency swap agreement with a Thai commercial bank (by selling the bank foreign currency with an agreement to buy back the full amount of the currency at a future date). According to BOT officials, most investors have opted for this fully-hedged requirement rather than go through the 30 percent URR process.

URR FAILED TO IMPACT EXCHANGE RATE

15. (C) Financial analysts do not believe that the intended impact of the URR, to slow the appreciation of the Thai baht, has been realized as the baht has risen 8 percent since the URR's enactment just over a year ago. While it could be argued that the baht would have risen more without the controls, the URR contributed to a decline in overall investor sentiment in Thailand, perhaps exacerbating the flat

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domestic investment (and import demand) conditions that made the current account surplus so unusually large. Furthermore, the URR created a two-tier market for the Thai currency, with the offshore baht price generally higher by 1.5 to 2 baht than the onshore rate (although that gap has narrowed with anticipation that the URR might be ended). In the words of Kasikorn Bank senior researcher Kobsidth Silpachai, the higher offshore rate created "a psychological reference point" for the baht's future direction, and made the baht's strengthening a self-fulfilling prophecy.

16. (C) In another view, former Finance Minister Chalongphon Sussangkarn, who stepped down when the current cabinet was inaugurated, told econoffs on February 12 that the URR carries mostly symbolic weight apart from the bond market, where its influence remains for instruments of less than one year's duration. "Because the initial controls were later watered-down, and with most investors opting to hedge their investments, there aren't currently very many inflows subject to the URR," he said. Chalongphob said the U.S. dollar's weakness was the primary driving force of the baht's appreciation over the past two years. A continual weakening of the dollar would make it all the more difficult for the BOT to prop up the baht in the long term, he added.

LIKELY OUTCOME - THE LATTER HALF OF 2008?

17. (U) While some market participants are optimistic about an immediate repeal of the URR (and the stock market has risen strongly this week on such anticipation), analysts are split on whether it will occur before Spring or in the second half of 2008. Factors weighing against removing the URR at this time include the recent sharp drop in U.S. interest rates, which makes Thailand more susceptible to capital inflows due to the relatively higher Thai rate, and the strong current account surplus which continues to place upward pressure on the baht. Analysts from Kasikorn Bank, Thailand's

second-largest private bank, predict that conditions to repeal the URR will ease in the second and third quarters of the year, when a drop in export growth is expected with the global economic slowdown, and the BOT has further reduced Thai interest rates. Analysts from Standard Chartered Bank have given a 60 percent chance that the controls will be lifted in the last three quarters of 2008 (calendar year), and a 40 percent chance that they would be lifted before then.

18. (C) Comment: Regardless of the ultimate economic impact of the decision, one thing seems clear: If the new Finance Minister succeeds in overturning the URR measure prior to his investment roadshow in March, it will be done over the objections of the BOT and signal the Finance Ministry's willingness to challenge BOT policy if it interferes with the new government's pro-growth policies. Such a move would give Surapong heightened stature among those who have questioned his influence.
JOHN